

Mortgage Loan Fraud and Mortgage Laundering: The Ugly Twins

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A deep recession and the depressed housing market have resulted in an increase in real estate and mortgage loan related suspicious activity. In fact, a report released by the U.S. Financial Crimes Enforcement Network in April 2008 says that SAR (Suspicious Activity Reports) activity related to the residential real estate industry is on the rise and with the refinancing of mortgages this trend will continue.

A report released in the same month by the U.S. Federal Bureau of Investigation on mortgage fraud corroborates this statement. According to the FBI, fraudsters often take advantage of desperate real estate owners, and personnel trying to maintain their standard of living. Statistics in the report indicated that mortgage fraud related SARs rose by more than 10,000 in 2007.

Connection between mortgage loan fraud and laundering

There is a clear connection between mortgage loan fraud (for profit) and money laundering, as the money launderer often commits mortgage loan fraud in order to conceal ill-gotten gains. Often, both launderers and fraudsters often make use of “straw buyers,” people who allow their names and credit ratings to be used to secure fraudulent mortgage loans.

The real estate industry is very susceptible to money laundering. The use of real estate to launder money seems to afford criminal groups many advantages:

- it allows them to introduce illegal funds into the system
- they may earn additional profits
- they may even obtain tax advantages (such as rebates, subsidies, etc.)
- mortgage broker channels largely are unregulated.

Here is an overview of the differences and similarities between mortgage loan fraud (for profit) and mortgage loan laundering:

	Mortgage Loan Fraud for Profit	Mortgage Loan Laundering
Goal	Making illicit profit by defrauding lender or consumer, or by quickly flipping the property	Conceal the ill gotten gains of another illicit transaction (for example sale of pirated DVDs). By getting an unnecessary loan, the launderer can disguise illicit funds as the proceeds of business loans.

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Use of straw buyers (individuals willing to accept a fee to allow their identities to be used to apply for residential real estate loans)	Yes, use someone (straw buyer) with good credit to obtain the loan, and then walk away with the money.	Yes. Once the loan is approved and funded, the launderer moves the money out of the straw buyer's account and may move it into another straw buyer's account to repeat the process.
Defrauding of lending institution or consumer	Yes, by means of dishonest appraiser, or identity theft (sending change of address and then obtaining credit against the home equity loan)	No. Criminals want to abuse the lender to launder the proceeds of other crimes, not steal money from the lender, or from consumer.
Making scheduled payments	No. Typically, the borrower defaulted on payment. When the bank tries to recover the debt from the straw buyer, this person does not know who was really behind the operation or where they might be located.	Yes. Will strive to project an image of normalcy by making the scheduled payments on the loan, integrating the funds into the financial system. The loan payments (often made with money orders bearing the name of the straw buyers, or other negotiable instruments) are made by the launderer on a timely basis using illicit funds.

Don't just scrutinize real estate industry clients

According to a SAR, a mortgage officer of a bank was discovered supplying reference letters to non-resident aliens on mortgage loans. It was discovered that this employee had a business relationship with both an appraiser and a real estate agent involved in the sale of all the properties involved. Because all of the loans were performing and did not default, it may be indicated that these were straw buyers who obtained mortgages which were then used to launder funds as payments were made.

The above-mentioned case is not the norm. As a financial institution you might feel that scrutinizing real estate industry clients may be enough to protect you; however, according to the FinCEN report more than 75 percent of residential real estate related SAR subjects were unaffiliated with the real estate industry.

It is very important that your institution's policies include conducting due diligence on customers who ask for mortgage loans. In one example from the FinCEN report, a bank declined a borrower's mortgage loan application because of information it had obtained on the internet. As it turned out, the customer was under investigation for laundering up to \$500,000 in dirty money per week. "Know Your Customer" policies and procedures may help in detecting potential fraudsters.

Red flags

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There are red flags that your institution can watch out for in order to make sure that you are not involved in a scheme like this. The Financial Action Task Force, a Paris-based international organization dedicated to aiding governments in establishing anti-money laundering controls, lists several red flags in a 2007 report on money laundering through the real estate sector. A few of these include:

- Individuals who unexpectedly repay problem loans or mortgages or who repeatedly pay off large loans or mortgages early, especially if in cash.
- Transactions involving recently created companies when the amount is large compared to their assets.
- Indications that the parties are not acting on their own behalf and are trying to hide the identity of the real customer.
- The customer is not interested in improving the terms of the loan.
- The customer does not appear interested in the specifics of the transaction, for instance the date on the loan or when the property will be handed over.
- Customers who express strong interest in buildings in a certain area, regardless of what price the property is going for.
- Transactions made by a third party that is not involved in the initial sale of the property.

Another step that some institutions are taking in order to protect themselves involves the form 4506T. This form is filed with the U.S. Internal Revenue Service to verify tax information and is normally required at the closing of the loan. Some institutions have begun to require this form during the application process instead.

Fraud and compliance converges

We saw earlier in this article that there is a clear connection between mortgage loan fraud (for profit) and money laundering, as the money launderer often commits mortgage loan fraud in order to conceal ill-gotten gains. This is a good reason to more closely integrate fraud and AML compliance departments. An efficient anti-money laundering program is instrumental in protecting an institution from mortgage fraud. Integrating these departments allows each to work more effectively by eliminating common redundancies.

As the housing market crisis worsens, it will be increasingly important for your institution to fight fraudsters and money launderers who are abusing the situation. By paying attention to these red flags and working together, your institution can protect itself from money laundering through real estate and mortgage fraud.